DSG
DEFENCE SUPPORT GROUP

ANNUAL REPORT AND ACCOUNTS
2010/2011

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MINISTRY OF DEFENCE

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INTRODUCTION FROM THE CHAIRMAN

As its Chairman, I am delighted to once more have the opportunity of introducing the Annual Report and Accounts of the Defence Support Group (DSG).

A new government and administration in 2010 brought with it its own set of significant challenges for everyone in the public sector and DSG is certainly not immune to the cost and manpower savings required during this period of severe austerity.

In this third year of trading, DSG has again delivered a sound and solid business performance of which the whole organisation can be justifiably proud. The board is grateful to the DSG employees for their continued commitment and effort in delivering a top class service to their Armed Forces customers.

JAMIE PIKE
DSG Chairman

During the year Terence Jagger stood down as one of DSG's Non-Executive Directors to take up an appointment elsewhere in MOD and we are grateful for the significant contribution he made in making DSG so successful. In October 2010 we welcomed his replacement David Williams to the Board. David has a wealth of experience in MOD Centre as well as other parts of the public sector. Unfortunately, we were unable to make full use of David's extensive expertise for long as he swiftly moved to another senior position elsewhere in MOD. David's replacement from 1 April 2011 as Head of Business, Strategy & Governance in MOD Centre is Emma Davies and we welcome Emma to the DSG Board.

It is the responsibility of the Non-Executive Directors to provide advice, guidance and challenge to the DSG Management Board using the many skills and expertise we have all developed over many years in senior management roles in both public and private sector businesses. This role also extends for me in supporting DSG's Chief Executive on the Ministerial Owner's Advisory Council chaired by MOD's Minister for Defence Equipment, Support and Technology (Min DEST), Peter Luff MP.

It is clear from our experiences during the past year that DSG customers are facing some tough and difficult decisions to take on where their priorities lie in the future. The more detailed outcome of the Strategic Defence and Security Review announced by the Defence Secretary in October 2010 aims to give greater clarity to the wider MOD and industry on future funding. It is clear, however, that belts will tighten and future requirements will undergo deep scrutiny in order to achieve maximum value for money from a more streamlined and efficient support function. A significant element of the Review recommends that MOD pursues a course of action to bring about the sale of DSG. MOD Centre is now in the early stages of developing the processes to gauge potential interest and identify the accrued benefits to defence any sale may bring to MOD and the UK taxpayer.

DSG has established an excellent reputation across the defence sector in a relatively short space of time and this is due, in no small measure, to the positive attitude and extensive skill-base of its workforce. This is particularly evident in its key role currently supporting the Equipment Sustainability System now underway at Camp Bastion in Helmand Province, Afghanistan. It is examples such as these that show the customer community and the wider defence industry the breadth of capabilities that exist in DSG and their acknowledged value to the UK Armed Forces.

Jamie Pike
Chairman
Defence Support Group
30 June 2011

STATEMENT BY THE CHIEF EXECUTIVE

The latest Annual Report and Accounts of DSG are set against a year of great change across all areas of public service and at every level. DSG employees rose above uncertainty and concern to produce another excellent performance against some very challenging circumstances.

ARCHIE HUGHES
Chief Executive

For employees in DSG's Large Aircraft business at St Athan the year started with feelings of great insecurity over the impending redundancy programme, with particular concern over the compensation packages they would receive due to planned changes to the Civil Service Compensation Scheme. Although any redundancy situation is to be regretted, following negotiations with Ministers and Trade Unions we were able to implement a scheme delivering the most beneficial outcome for these employees.

As part of the 2010 Comprehensive Spending Review (CSR) all Government departments were asked to review their budgets and in addition examine their assets and consider how they could be managed more effectively, including considering the role of privatisation and contracting out where assets did not need to be held in the public sector. As part of this exercise the MOD reviewed a number of assets to identify the most appropriate business model to ensure best value for money for defence and wider government. As part of this exercise the Strategic Defence and Security Review (SDSR) was published in the autumn and it included the announcement that DSG would be one of the MOD owned assets which would be offered for sale.

The privatisation process is one which some of DSG's employees are already familiar. They witnessed the sale of the Defence Aviation Repair Agency's (DARA) Rotary and Components businesses in Hampshire and Perthshire, prior to the merger of its remaining businesses with ABRO to form DSG in 2008. They will carry on as normal and continue to do the best possible job whilst the sale process is managed directly by MOD.

MOD is now in the process of defining exactly how and when this sale process will proceed, and as such the sale announcement has had no material impact on the business this year.

We also know that DSG is not immune to increased pressures on budgets and it is clear we must achieve savings and we have to play our part, however small, to help balance the budgetary deficit.

DSG's greatest asset is its people. However, as with a lot of businesses, this is also one of the greatest costs and when there are pressures to reduce costs this inevitably results in the need to reduce the number of employees in the business.

Despite major cost savings and efficiencies delivered by DSG since its formation on 1 April 2008, the business is faced with a declining order book. It must therefore begin a major structural reform to realign its capacity and capability with Defence customers' reducing demand and as a consequence our own Min DEST, Peter Luff, announced to Parliament on 28 October, that he was beginning the formal Trade Union consultation over the planned reduction of up to 600 staff from DSG by 2013. These reductions are necessary in order to match the DSG capacity to the projected future workload, and to maintain our profitable trading position, whilst ensuring we continue to provide the support required by our Armed Forces customers.

On a more positive note DSG has been working hard over the last year to expand our portfolio and take on additional activity from the MOD. From April to September 2010, we conducted an Evaluation Phase into transferring the vehicle activity of what was then the Defence Storage and Distribution Agency (now Joint Support Chain Services (JSCS)) to DSG. During this phase, DSG teams evaluated and collected information on the JSCS vehicle businesses at Ashchurch, Catterick, Longmoor and Warminster sites. The output from the evaluation phase recommended that DSG proceeds into the next phase of the project, the Interim Operating Model (IOM), where DSG has effectively been managing the activity whilst the staff remain part of JSCS. The plan is now to move as quickly as possible to a Final Operating Capability (FOC) where we take full ownership of the activity, including the employees. JSCS, however, will retain responsibility for the site infrastructure facilities and provision of a safe working environment.

The transfer of vehicle activities from JSCS to DSG is a very important opportunity for us and means that we are now involved at all stages in the life of various equipment platforms from initial receipt by MOD to eventual disposal, as well as all the maintenance and support activities during the equipment's life span.

The dominating factor throughout this trading year was the increased level of activity associated with DSG's role in supporting Front Line operations at Camp Bastion in Helmand Province, Afghanistan. Under the banner of PJHQ's Equipment Sustainability System the Defence Secretary, Dr Liam Fox, formally opened DSG's Regeneration Capability facility in Camp Bastion in January 2011. He was accompanied by Her Majesty's Ambassador to Afghanistan, Sir William Patey KCMG; the UK's Attorney General, Dominic Grieve QC and Commander Joint Operations, Air Marshal Sir Stuart Peach. This was the first time a Minister had visited the completed facility, which DSG operates for MOD alongside its industry partners.

The party all commented positively on the success of the programme to date and the benefits it is bringing to Operations. In his interview with the British Forces Broadcasting Service, Dr Fox explained how good it is to celebrate something new that is innovative and a centre of excellence. He went on to say:

"It shows that we can get something right when we put our minds to it. This is going to provide us with cutting edge facilities and ultimately save us money. Excellence and savings are words we are going to use quite a lot in 2011 and this is a perfect example of it. Congratulations to everybody in making the project work so successfully, within budget and on time. That is something the rest of the MOD need to learn well from and to congratulate you on what is a great achievement, and to say thank you very much on behalf of all our Armed Forces for you in support, sometimes the unsung heroes. We need to do some more singing sometimes."

Touring the workshop, Dr Fox reviewed the work undertaken by the DSG repair teams. The sheer size of the facility and the numbers of platforms undergoing repair impressed him greatly. In discussions with the DSG team, our staff explained how they bring their unique skills and knowledge to the task in hand. He was also interested to learn that DSG is growing the capability in Bastion from the initial concept of platform regeneration through to intimate support to the REME Battalion and repair of electronic and mechanical sub-systems.

DSG is never short of volunteers committing to deploying to Camp Bastion for long periods away from their homes and loved ones. They are all excellent ambassadors for our business and the roles they are performing on a daily basis are certainly appreciated by their Armed Forces colleagues with whom they have daily contact at every level.

In conclusion, DSG's trading performance during the year was solid. We again met or exceeded all of our Key Targets, which is all the more commendable given this was achieved amid a climate of uncertainty with headline concerns over employee reductions, budget cuts and future job prospects for everyone working in the public sector. Next year will be no less challenging for DSG and its employees but I am sure that the commitment and pride that every DSG employee has in their role supporting the UK's Armed Forces will again produce a sound business performance albeit against an austere and uncertain future for everyone.

A. Hughes

Archie Hughes
Chief Executive
30 June 2011

BOARD OF DIRECTORS

ARCHIE HUGHES
Chief Executive

JOHN REILLY
Chief Operating Officer

DAVID MORGAN
Commercial Director

ARCHIE HUGHES
Chief Executive

Archie Hughes is responsible to the Owner and Parliament for delivering the strategic aims and objectives of the business and providing corporate governance leadership.

Archie was DARA's Chief Executive from January 2004 until he assumed responsibility for the merger of ABRO and DARA in July 2007 to form the Defence Support Group when he took on the role of Chief Executive. He has extensive experience in changing business culture; delivering improved business performance; and acquiring, integrating and managing high technology engineering and manufacturing businesses in the Defence and Aerospace Industries. An honours graduate from Strathclyde University, he was previously Chief Executive of Vickers Defence Systems (VDS), encompassing Specialist Engines and Vickers OMC as well as the Main Battle Tank and Military Bridging businesses.

JOHN REILLY, OBE
Chief Operating Officer

John Reilly, Chief Operating Officer is responsible for all of DSG's operational businesses and determining the Operational Excellence strategy of DSG. He is also responsible for a number of other business support functions including Quality, Environment, Safety, Health, Information Services and Facilities.

John was Chief Operating Officer at DARA from 2001 until he assumed the role of Chief Operating Officer following the formation of the Defence Support Group. He joined MOD in 1975 after a successful four-year engineering apprenticeship in industry. He has an MBA from Abertay University and has worked on a number of major programmes within MOD. He was awarded the OBE in the Queen's Birthday Honours list in 2006 for his contribution to the defence industry.

STEVE HALL
Finance
Director

DEREK OWEN
Human
Resources
Director

KEITH NORRIS
Strategy
Director

DAVID MORGAN
Commercial Director

David Morgan is responsible for all DSG's customer and supply chain activities across the various business interests.

Prior to joining DSG, David was Commercial Director for the Technology Solutions Sector at QinetiQ with responsibility for building a team supporting the commercial negotiating and management of contracts at both a national and international level.

Starting his career at British Aerospace, he moved into senior commercial roles at both KBR and Logica.

STEVE HALL
Finance Director

Steve Hall, Finance Director is responsible for financial strategy, propriety and governance and the delivery of high quality management information to the business.

Steve was previously Finance Director at DARA until he assumed the role of Finance Director in the Defence Support Group. He has extensive experience in finance, change management and project management gained from 20 years in a variety of senior roles in MOD and its Agencies. Prior to joining DARA, Steve was Finance Director for Military Survey.

DEREK OWEN
HR Director

Derek Owen, HR Director is responsible for the full HR function as well as internal communications, parliamentary business and security policy.

Derek was previously HR Director at DARA until he assumed the role of HR Director in the Defence Support Group. He worked in Germany for nearly three years as HR Manager for The Health Alliance, an innovative partnership with Guy's & St Thomas' Hospital Trust and the Soldiers', Sailors' and Airmen's Families Association responsible for delivering health care to British Forces in Germany. He has extensive HR, employee relations and change management experience in a variety of roles throughout the MOD and with all three Services, although notably with the Army. He is a Chartered Fellow of the Chartered Institute of Personnel and Development and a Chartered Fellow of the Chartered Management Institute.

KEITH NORRIS
Strategy Director

Keith Norris was appointed as the Defence Support Group's Strategy Director in January 2008. He previously led the DARA Rotary and Components sales team within MOD Centre having previously conducted a number of strategic reviews of ABRO and DARA. He has worked extensively overseas, including Hong Kong as Assistant Civil Secretary – British Forces; Germany as secretary to the Tornado Board; Saudi Arabia on the Al Yamamah project and more recently as project director of the UK/South African Strategic Defence Equipment Programme.

JAMIE PIKE
Chairman, an independent Non-Executive Director

JANET BAKER
Independent Non-Executive Director

DAVID BARRASS
Independent Non-Executive Director

JAMIE PIKE
Chairman

As Chairman of DSG, Jamie Pike is responsible for leading the Board to ensure it operates efficiently and effectively and to oversee and scrutinise the organisation's plans and performance.

Jamie began his career as a management consultant before joining Burmah Castrol in 1991. He rose to Chief Executive of Burmah Castrol Chemicals before leading the buy-out of Foseco, in 2001 and its subsequent flotation in 2005. He was Chief Executive of Foseco plc until it was acquired in April 2008. He has previously been a Non-Executive Director of RMC Group plc, Kelda Group plc and the Army Training and Recruitment Division. He is currently Chairman of the RPC Group plc, a quoted plastic packaging business and Chairman of MBA Polymers Inc., a plastics recycling business, which is a private company incorporated in the USA.

JANET BAKER
Non-Executive Director

Janet Baker has had a lengthy career in management consultancy, firstly with Coopers and Lybrand followed by Ernst and Young and then as a Senior Partner with PA Consulting Group. After leaving full-time consultancy work in 2006, she became a Non-Executive Director on the Board of the HealthCare Purchasing Consortium. She is now a Commissioner (NED) of the Audit Commission and a member of its Audit Committee, a Non-Executive Director of HM Treasury's Risk and Audit Committee, and a Non-Executive Director on the Board of the Rural Payments Agency.

As a Non-Executive Director to the DSG Trading Fund Board, Janet's role is to provide expert advice, guidance and challenge to the DSG Management Board. She is a member of the Audit Committee and Chairs the Remuneration Committee.

DAVID BARRASS
Non-Executive Director

David Barrass's experience covers a broad range of industries both in the UK and internationally and he is currently Chairman of both CastleCare Group Ltd and Material Advantage Group Ltd. A professional Interim Manager, his most notable recent assignment was as CEO and Deputy Master of the Royal Mint where he delivered a major turnaround of the business.

As a Non-Executive Director to the DSG Trading Fund Board, David's role is to provide expert advice, guidance and challenge to the DSG Management Board. He Chairs the Audit Committee and is a member of the Remuneration Committee.

BUSINESS, MISSION, VISION AND STRATEGY

MISSION

To provide expert in-house maintenance, repair, overhaul, upgrade and support services for the UK Armed Forces' air and land systems.

VISION

Excel in Supporting Defence.

STRATEGY

The Defence Support Group enables MOD to secure access to assured onshore capacity and capability for the through life maintenance, repair, overhaul, upgrade and procurement services for strategically important Defence equipment. DSG's core mission is to support the UK Armed Forces and deliver wider Defence objectives, including current and future MOD equipment acquisition and support strategies.

It will pursue a strategic goal of achieving 'best value for Defence' through focusing on and delivering, where appropriate, cost reduction, efficiency and productivity improvements, and improved delivery to the customer across all areas of the business;

In support of this, the strategic aims of DSG are as follows:

- Not withstanding the SDSR/CSR decision to sell DSG, it will go forward as a Trading Fund during the period of this Plan;
- It will provide physical assembly, integration and test capabilities as required by the customer/industry;
- It will be agile, flexible and provide its services directly to MOD or indirectly through industrial primes/Original Equipment Manufacturers (OEMs) where it will position itself to be the partner of choice on major Land equipment acquisition programmes.
- As a retained defence capability, its utility will be maximised and where necessary sustained to provide a core capability to MOD customers. It will work closely with MOD customers to ensure that it is appropriately funded to enable it to retain the required capacity and capability to support planned future acquisition and support strategies;
- It will continue to provide a flexible response to meet evolving operational requirements, particularly in terms of surge and Urgent Operational Requirements (UORs) and will provide support to deployed operations and training for operations and develop its capabilities to provide support to customers at their preferred locations;
- It will build upon and grow its capability and knowledge base in support of Defence assets, including its ability to utilise MOD free user rights of 3rd party IPR;
- It will focus on developing the necessary capabilities to enable it to be deployed in a flexible manner as part of planned future procurement and support strategies;
- It will be a modern, lean organisation, structured as a series of Business Streams, as well as the Land Supply Business Unit, supported by a slim line Head Office; and
- It will take forward any DSG specific recommendations of the Strategic Defence & Security Review and Defence Reform.
- It will actively explore opportunities for supporting MOD in the management of current and future land vehicle fleets.
- It will support the development of the Land customer Integrated Equipment Support Model as well as other customer initiatives such as the Defence Support Review and the Whole Force Concept.

PERFORMANCE AGAINST KEY TARGETS

The Minister for Defence Equipment, Support and Technology endorsed DSG'S Key Targets for 2010/11. For its third year of trading DSG has developed Customer-focused Key Targets that will help to build upon FY2009/10 levels of performance and improve longer-term efficiency through close structural alignment with Customer planning assumptions.

PERFORMANCE AGAINST KEY TARGETS 2010/11:

Key Target 1: **Quality** Deliver an improved quality performance by: • Air - achieving fewer than 3 attributable Major Customer Concerns; and • Land – implementing a new system to record 'Major' Customer Concerns for the Land Business and set a baseline against which future years' targets can be set.	**Achieved**
Key Target 2: **Financial Performance** To achieve at least a 3.5% Return on Capital Employed.	**Achieved**
Key Target 3: **Efficiency** To develop a phased DSG Capacity and Capability Optimisation Plan.	**Achieved**
Key Target 4: **Delivery** Meet delivery targets as agreed with the Customer as follows: • Air Business – To achieve 95% of Customer Programmes; and • Land Business – To meet Customer agreed targets for delivery schedules on: Critical Programme Lines (94% Sep 10, 94% Dec 10 and 97% Mar 11) and LAND Load Tasks (92% of Urgent Specified Tasks, 85% of Routine Tasks).	**Achieved**

FUTURE PERFORMANCE INDICATORS

PERFORMANCE INDICATORS

For FY2011/12 DSG is moving away from annual Agency Key Targets agreed with MOD Ministers to a regime of business reporting against internally agreed business measures designed to ensure improved performance in areas critical to DSG performance.

DSG will publish the business measures for FY2011/12, and report its performance against them with a short narrative, in the annual report and accounts for that year.

BUSINESS PERFORMANCE REVIEW

Each business unit faced its own set of challenges throughout the last trading year during a period of sustained change. The most significant development across DSG's Land sector businesses was the emerging roll-out of a new Enterprise Resource Planning process incorporating a bespoke Baan system. Baan is already implemented across DSG's Air businesses and by introducing this system across all DSG's business units it brings synergies and savings that benefit DSG and its customers.

First site to cut-over to Baan and act as the project's pilot was Stafford, which went live on 2 June 2010 followed by DSG's corporate area and Business Stream 1 at Donnington in November 2010. The Electronic and Components business unit based at Donnington went live on 31 January 2011 with DSG's remaining sites encompassing Business Stream 2 completing the implementation phase on 4 April 2011. The move to a single ERP system is just one step in the transformation journey that DSG is taking but this achievement is a significant one and was only achieved through the commitment of the implementation team and the close co-operation the members of the team received from the DSG employees.

At DSG's Large Aircraft Business Unit (LABU) in St Athan, the last two VC10 major overhauls in the Superhangar were completed by December 2010 on time and the business is now fully relocated in the Twin Peaks hangar, with no negative impact on performance delivery or on the business. The employees leaving DSG under Tranche 1 of the closure programme have now left and there are now less than 200 employees who will oversee the remaining minor servicing and overhaul of the last of the VC10s prior to their removal from operational flying when the new Future Strategic Tanker Aircraft fleet comes into service.

This element of DSG's business has performed consistently well over many decades and remains the single largest contributor to DSG's positive trading performance in recent years and 2010/11 is no exception. The LABU employees, both past and present, can take great satisfaction and pride in their significant contribution supporting this iconic aircraft over many years.

Under the new reporting regime implemented at the start of 2010 the majority of functions undertaken at Donnington, Sealand and Stafford now come under the responsibility of Business Stream 1. The exceptions to this are DSG's Land Supply business which relocated from Telford in January 2011 to its new base at Donnington, which is managed by the Head of Land Supply reporting directly to DSG's Commercial Director. The other activity undertaken at Donnington unrelated to Business Stream 1 is the maintenance of the local Army Units' wheeled vehicles, which now comes within Business Stream 2's area of responsibility and managed through DSG's Catterick site.

As DSG's largest site, Donnington is undergoing a major transformation across its varied functions while continuing to meet demanding customer deadlines and fluctuating workloads. With increased pressures on the budgets of its customers, Donnington has had to adapt quickly and change priorities to deliver an acceptable performance against some unforeseen and difficult circumstances. High on its priority list is the support it provides to on-going overseas operations, particularly those in Afghanistan where some of its employees deployed to support DSG operations at Camp Bastion. At home its support is no less onerous or important as the site works hard to turn round equipment under the banner of Urgent Operational Requirements (UOR). This has included working on upgrades to Wheelbarrows in order that they were compatible with the Mastiff vehicles, to overhauling and refurbishing early warning systems mounted on trailers.

DSG's Electronics and Components Business Units at Sealand and Donnington were able to produce a solid business performance despite reductions in work volumes coming through the workshops. This performance was due, in the main, to prudent management of costs and an opportunity to develop a role for this area of the business in the DSG support facility at Camp Bastion in Afghanistan where the skills of the Sealand and Donnington employees are developing bespoke repair solutions in battlefield conditions.

Business Stream 1's facility at DSG Stafford faced similar challenges with reducing workloads but once again was able to turn these challenges around with sound financial management and deliver a respectable profit for the business. DSG Stafford employees have shown during the year their great capacity to adapt to the demands and needs of their customers, which included taking two trips within a week to the Falkland Islands to remove, repair and re-install Air Separation Units. This commitment to satisfying DSG's customers is endemic across DSG and helps enhance the image of the business across the defence sector and within, most importantly, the customer community.

The geographic coverage of Business Stream 2 encompasses all the countries in the UK as well as providing support overseas when required by the military customer. This has included support to training fleets in Canada and Germany as well as overseeing our deployment of personnel to Camp Bastion.

Much of Business Stream 2's revenue comes from DSG's close involvement with the MOD's Land District Load programme, which provides the valuable support to military units across the country that are so dependent on our capabilities across a range of platforms for non-programmed work. This revenue stream forms a significant part of Business Stream 2's annual turnover and involves its sites at Stirling, Kinnegar, Catterick, Colchester, Warminster and Bovington. The latter is Business Stream 2's major site, which is providing the administrative support to DSG's overseas deployment efforts as well as completing Challenger tanks, UORs over and above the routine base maintenance, repair and upgrade work across a number of tracked and wheeled vehicle platforms.

During the year a core team of DSG personnel worked closely with staff from the JSCS, which is part of MOD's Defence Equipment and Support (DE&S) department, working towards the successful transfer of vehicle activities from JSCS to DSG at the Ashchurch, Catterick, Longmoor and Warminster sites. This transfer of activity enhances DSG's overall capability and offering to the defence customer by exploiting synergies and opportunities across a range of vehicle platforms.

DSG's ability to operate successfully in a fast-moving environment where priorities change overnight depends on a stable and effective range of support functions. During the past year DSG's Information Services (IS) department consolidated its infrastructure network with the aim of delivering a more efficient and single set of IT processes across all DSG's business areas. With so many DSG employees reliant on computer technology to do their job, the role of IS is one that is critical and DSG's IS team is fully committed to supporting and developing solutions to suit the changing needs of the business.

Cost effective and efficient estate management across so many DSG sites has its own set of unique challenges. One key development during the year was the successful transfer of employees from DSG's Land Supply Business Unit from offices on the Sapphire Park business park in Telford to a newly refurbished building on the DSG Donnington site. Reducing their footprint on the MOD St Athan site, DSG employees are now collocated under the roof of the Twin Peaks hangar having vacated the Superhangar at the end of 2010 following the departure of the last VC10 aircraft to undergo major servicing at the base.

Developing the skills of its workforce remains a high priority for DSG and this is most evident in its apprentice programme. Although it has to match future manpower levels against projected work volumes the DSG apprentice scheme continues across many of its sites to critical acclaim. MOD's most prestigious apprentice award was won for the second successive year by a DSG apprentice. This year it was the turn of DSG Catterick's Daniel Wright who travelled to London in December 2010 to receive his award from Gerald Howarth MP, Minister for International Security Strategy at a special awards ceremony. Daniel was one of a number of DSG apprentices from across the business who received awards at the event.

The employees of DSG are its greatest ambassadors, with many playing active roles in their local communities as well as supporting charities and worthy causes to help those who are disadvantaged or in need of help and support in difficult or life threatening circumstances. This has involved one DSG employee driving to Mongolia and back as part of a trip to raise funds for the Help for Heroes charity or another running the London marathon for a Breast Cancer campaign.

In October 2010, the Minister with responsibility for DSG, Peter Luff MP, announced in Parliament that consultation with the Trades Unions would begin to reduce the manpower levels in DSG by up to 600 due in part to increased efficiencies and better ways of working as well as combating reducing workloads and pressures on the budgets of its military customers. The national TU officials met with the Minister and senior DSG management in early 2011 to discuss options to avoid any reductions in employee levels and it was agreed to continue with the consultation during the second phase of the process, which is exploring from where in DSG the reductions will come.

DSG's interface with its customers, partners and wider industry is crucial to the long-term success of the business. DSG's commercial functions provide the platform for developing and sustaining positive relations with its key stakeholders both within MOD and across defence markets throughout the world. DSG also holds Industry Days, when many of DSG's key suppliers from industry meet with representatives from DSG and DE&S to strengthen existing relationships and encouraging continuous improvement for the benefit of all.

Listening to customers and taking actions to improve its performance is a fundamental element of DSG's customer review programme where DSG review its activities and develop improvements to meet the changing needs of our various customers.


LA16 AB

With a freeze on marketing and advertising spend across most of the public sector, DSG reduced it's spend significantly during the year and MOD made the tough decision to cancel DVD 2011, its showcase event at Bedford. Traditionally this was an annual event where industry and the military from all over the world converge on the Millbrook Proving Ground to look at the latest technologies and equipment now available to the UK's Armed Forces. But in an atmosphere of austerity and stretched budgets it was of little surprise to learn that the event would not take place in 2011. However, DSG's participation in the 2010 event was the key promotional highlight of the year where DSG management met with leading figures in the defence industry and from all levels within the customer community.

Effective communication within any organisation is vital to ensure key messages are delivered in a timely fashion and are of particular relevance to the audience. DSG along with the other MOD Trading Funds and certain MOD-wide departments and service clusters were scrutinised closely by MOD Centre and the Cabinet Office during the year to ensure they were delivering value for money on all their communications activities. DSG's in-house magazine Digest was one of only a few titles amongst many hundreds across MOD given authority to continue with its publication. During the year DSG published its renewed Communications strategy, taking into account the stringent budgetary constraints now imposed across Whitehall departments.

DSG lays great store in maintaining positive working relationships with local and trade media as well as with locally elected representatives of central government and those in the devolved administrations. Covering most areas of the UK, DSG and its sites continue fostering good relations within the communities in which they are located.

DSG employees have shown great resilience and maintained focus during the year, particularly in this period of continued uncertainty. What the future holds for the employees and the business is uppermost in all their minds. Matching future capacity to existing capability is a fundamental and immediate priority for DSG and its employees and will remain so for the foreseeable future. It is clear that its customers are great supporters of the business and they value the contribution DSG makes in supporting the Armed Forces but the reality is that maintaining the status quo is not an option open to DSG in the future. The total number of working days lost due to sickness was 32,243 which equates to 9.8 days per employee.


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FINANCIAL PERFORMANCE REVIEW

DSG successfully completed its 3rd year in business as a Trading Fund within the UK MOD and reported excellent financial performance in the year to 31st March 2011 with good profits and a healthy financial position.

Overall, DSG's financial performance exceeded its plan with a Profit before Interest and Dividend of £8.2m.

TRADING RESULTS

DSG achieved turnover and profit better than plan, with below plan operating costs.

The Return on Capital Employed achieved was 7.99%.

CASH FLOW AND FUNDING

The capital structure of DSG on formation was defined in the DSG Establishment as a Trading Fund Entry Terms document.

At 31 March 2011 DSG had Public Dividend Capital (PDC) of £23.3m and Government Loans of £28.3m.

Liquidity was strong throughout the year with a closing net cash position at 31st March 2011 of £36.1m.

CAPITAL INVESTMENT

Expenditure on capital projects amounted to £0.2m during the year.

DIVIDEND

DSG has provided in the Accounts for a dividend of £2.3m to be paid to the MOD in respect of the year 2010/11.

STATEMENT OF ACCOUNTING OFFICER'S RESPONSIBILITIES

Under Section 4(6) of the Government Trading Funds Act 1973, HM Treasury has directed DSG to prepare for each financial year a statement of accounts in the form and on the basis set out in the Accounts Direction. The accounts are prepared on an accruals basis and must give a true and fair view of the state of affairs of DSG and of its profit, changes in taxpayers equity and cash flows for the financial year.

In preparing the accounts, the Accounting Officer is required to comply with the requirements of the Government Financial Reporting Manual and in particular to:

- observe the Accounts Direction issued by HM Treasury, including the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;
- make judgements and estimates on a reasonable basis;
- state whether applicable accounting standards as set out in the Government Financial Reporting Manual have been followed, and disclose and explain any material departures in the financial statements; and
- prepare the financial statements on a going concern basis.

The Accounting Officer of the Ministry of Defence has designated the Chief Executive of DSG as Accounting Officer for the Trading Fund. The responsibilities of an Accounting Officer, including responsibility for the propriety and regularity of the public finances for which the Accounting Officer is answerable, for keeping proper records and for safeguarding DSG's assets, are set out in Managing Public Money published by the HM Treasury.

As far as I am aware there is no relevant audit information of which DSG's auditors are unaware and as Accounting Officer I have taken all the steps that ought to have been taken to make myself aware of any relevant audit information and to establish that DSG's auditors are aware of that information.

A. Hughes

Archie Hughes
Chief Executive and Accounting Officer
30 June 2011

STATEMENT ON INTERNAL CONTROL

SCOPE OF RESPONSIBILITY

As Accounting Officer, I have responsibility for maintaining a sound system of internal control that supports the achievement of DSG's policies, aims and objectives, whilst safeguarding the public funds and departmental assets for which I am personally responsible, in accordance with the responsibilities assigned to me in Managing Public Money.

As Chief Executive of DSG, I am personally accountable to the Secretary of State for Defence for the performance of DSG in accordance with the Framework Document and DSG's Corporate Strategic Plan. The DSG Owners Advisory Council, chaired by the Min DEST as representative of our owners, meets quarterly to review DSG's performance against its key targets and Business Plan objectives.

THE PURPOSE OF THE SYSTEM OF INTERNAL CONTROL

The system of internal control is designed to manage risk to a reasonable level rather than to eliminate all risk of failure to achieve policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on an ongoing process designed to identify and prioritise the risks to the achievement of DSG's policies, aims and objectives, to evaluate the likelihood of those risks being realised and the impact should they be realised, and to manage them efficiently, effectively and economically. The system of internal control has been in place in DSG for the year ended 31 March 2011 and up to the date of approval of the annual report and accounts, and accords with Treasury guidance.

CAPACITY TO HANDLE RISK

The DSG Board has provided leadership to the risk management process through the regular consideration of risk, at The Trading Fund Board, The Executive Management Board, The Executive Governance Review Group and Audit Committee meetings, and by the risk management strategy and policy.

In addition The Risk Management Committee meets three times a year and reports to the Audit Committee and the Executive DSG Board. The role of the Committee is to act as a focal point for review, evaluation and monitoring of all DSG risks, including individual ownership of key risks and accountability for deciding appropriate action for making recommendations to the Board, or creating internal standards and procedures relative to the management of risk and for disseminating risk information and guidance on best practice.

Our procedures for corporate and business unit risk registers, together with our implementation of risk management for major projects, continues to ensure that risk management is embedded in all our business activities. We are continually assessing the approach to risk management, to ensure that all business units and projects continue to operate within Treasury guidelines. All business units and support directorates use the risk management software Active Risk Manager (ARM) and bid management areas are now also being included. Additional Business risk training for all business units has been completed along with supplementary training on the reporting mechanisms.

THE RISK AND CONTROL FRAMEWORK

DSG complies with HM Treasury instructions and guidelines for Corporate Governance. In order to meet the requirements of an embedded system of internal control, DSG has established a risk management system, which consists of: -

- **A Risk Management Policy with associated procedures**, which outlines the approach used within DSG for implementing risk management and includes a risk management reporting structure. This is reviewed on an annual basis and all staff have electronic access. The Risk Management Policy includes an information risk appetite statement which provides clear guidance on how risks to information are to be managed.

- **Appointed Risk Management Committee**, which reviews and evaluates internal standards and procedures relative to the management of risk and disseminates risk information and guidance on best practice. The committee is chaired by The Finance Director. The membership consists of the SIRO and key senior management representatives from across the organisation.

- **Appointed Risk Co-ordinators** within each Business Unit and Directorate who are responsible for the maintenance of local Risk Registers. A Risk Co-ordinators committee meeting, chaired by the Risk Manager, is held three times a year. The committee ensures a consistent approach to risk assessment across DSG is maintained and where it is assessed that a risk cannot be managed at the current level, or where the same risk has been identified across more than one business area, the risk is formally escalated to the next level for action.

- **A DSG Corporate Risk Register**, which represents the broad spectrum of corporate risks and is owned and reviewed regularly by the DSG Executive Board.

- **Business Continuity Plans**, which are managed by the Business Continuity planners to facilitate the unity of risk management and business continuity. All DSG sites have reviewed their Business Continuity Plans in 2010/11, and are subject to regular review in accordance with the DSG Business Continuity Manual action plan.

- **Insurance Policies** are in place to meet DSG's legal responsibilities and to mitigate certain risks. No insurance is taken against any potential liabilities to the MOD.

- **Information Risk Management** is being consolidated and strengthened with the appointment of Information Asset Owners and an Information Asset Management process under the control of the SIRO and this includes the protection of electronic data. There have been a number of recent audits and reviews in this area. Policies and procedures controlling the storage of information and access to the IT systems are being revised to accommodate the DSG policies and uploaded into the new DSG Business System, where all policies and procedures are held. There has been no loss of data or unauthorised release or loss of personal data. The ongoing activity to achieve level 2 Information Asset Assurance is almost complete.

- **Internal Audit Services** provide an annual risk and compliance based programme of internal audits. During 2010/11, in addition to the audit of the Key Targets, there were six major risk based audits completed, two of which gained full assurance, one substantial assurance, two limited assurance and one no assurance. In addition there were seven workshop audits, five of which achieved full assurance and two substantial assurance. The Executive Governance Review Group scrutinises all accepted recommendations with a target to ensure that they are implemented within three months.

REVIEW OF EFFECTIVENESS

As Accounting Officer, I have responsibility for reviewing the effectiveness of the system of internal control. My review of the effectiveness of the system of internal control is informed by the work of the internal auditors and the executive managers within DSG who have responsibility for the development and maintenance of the internal control framework, and comments made by the external auditors in their management letter and other reports. I have received satisfactory letters of assurance from executive managers and the DSG Governance Review Group. I have also received annual reports from DIA and HIA, both of which give an overall level of substantial assurance. The Board and the Audit Committee have advised me on the implications of the result of my review of the effectiveness of the system of internal control. Plans to address control weaknesses and ensure continued improvement of our processes are in place.

DSG has established the following processes to maintain and review the effectiveness of the system of internal control:-

- **A Trading Fund Board**, which meets at least 5 times a year to consider the plans and strategic direction of the organisation, comprising the Executive Directors of DSG and four external Non-Executive Directors, one of whom is Chairman of the Trading Fund Board, one is the chairman of the Audit Committee, and another is chairman of DSG's Remuneration Committee.

- **An Executive Management Board** which meets every month and controls the strategic direction of the organisation generates and reviews the corporate plans and reviews the Corporate Risk Register.

- **A Governance Review Group**, which comprises all Executive Board members together with the Head of Internal Audit and other key personnel as required. The primary purpose of the Governance Review Group is to monitor and review all assurance activities being undertaken within DSG. The group also aims to further develop Corporate Governance practices in general.

- Periodic reports from the Chairman of the Audit Committee, to the Board, concerning internal control.

- Regular reports from each Directorate as part of the performance management regime. An assessment of the key risks and their management/mitigation is included in these reports.

- DSG employees and the Board have been made aware of the Department's approach to Corporate Governance and the management of risk. This approach has produced a robust risk methodology using subjective assessments of Very High/High/Medium/Low/Very Low risks against the impact of a particular risk to DSG objectives as well as a likelihood of the risk maturing. These assessments are updated regularly and form the basis of the decision making process at the Board.

- Risk Registers are owned, maintained and managed by the business units and support directorates with a Corporate Risk Register owned and managed by the Board.

  The Risk Manager reporting through the Head of Internal Audit to the Finance Director has responsibility for coordinating and managing the Risk Management process.

- DSG risk management structure has been designed to ensure that information is communicated upstream and downstream within the organisation. Risk management is included as a regular agenda item at site and directorate meetings with links into the Business Continuity Plans. The risk management software, Active Risk Manager (ARM), is fully functional and reports are generated and issued to management to facilitate the control and mitigation of the risks.

INTERNAL CONTROL WEAKNESSES

For the financial year 2010/11, the internal audit process did not identify any areas of significant control weakness. However, we have received some internal audit reports, one with No Assurance, relating to handling of Government Furnished Assets and two with Limited Assurance relating to Financial Delegations and the management of Overseas Deployments. Whilst these are not satisfactory, actions are in place to rectify the issues raised and therefore I do not consider there to be serious control weaknesses. I am also pleased to report that there has been some improvement in the management controls of indirect areas of travel & subsistence and vehicle hire that were reported last year. The Executive Directors have been tasked with taking action to tighten these controls. There still remain issues relating to Work In Progress (WIP) reconciliations and goods received not invoiced accounting, which were not fully resolved by the year end, however the transition to a new ERP system will eliminate most of these issues during 2011/12. During the transformation process there will be a period of uncertainty and it is recognised that there will be new risks arising that will need careful management and control, but I am confident that our systems of internal control are more than adequate for the task.

Archie Hughes
Chief Executive
30 June 2011


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REMUNERATION REPORT

REMUNERATION COMMITTEE

The purpose of the Remuneration Committee is to agree the strategic policy in relation to the remuneration of DSG employees, consistent with the Personnel Delegations held by the Chief Executive of DSG.

The remuneration of all DSG employees except Senior Civil Servants (SCS) is set by the Remuneration Committee in agreement with HM Treasury.

The Remuneration Committee consists of the independent non-executives of DSG's Board and MOD's representative, with a representative from Human Resources to act as secretary. One of the non-executive directors is appointed to act as Chairman and other executive directors are invited to attend meetings to assist the committee in their deliberations as appropriate. The committee met as required during the financial year and all recommendations arising from the committee have been implemented.

The committee continues to make a positive input to the strategic direction of DSG pay settlements prior to ratification by the DSG Board.

REMUNERATION POLICY

The Chief Operating Officer, Finance Director and Human Resources Director are Senior Civil Servants. As such their pay is set through recommendations made by the Review Body on Senior Salaries. The Review Body on Senior Salaries provides independent advice to the Prime Minister and the Secretary of State for Defence on the remuneration of SCS taking account of evidence it receives about wider economic considerations and the affordability of its recommendations. Further work about the work of the Review Body can be found at www.ome.uk.com.

All other employees have their remuneration determined by a process consistent with MOD and Treasury regulations. The Chief Executive has delegated powers for the setting of terms and conditions of employment, including pay, for all DSG employees below SCS. This delegation requires him to consult with the MOD and HM Treasury before agreeing to any changes to pay and grading systems and arrangements. This is achieved through the pay remit process whereby the DSG Pay Strategy is submitted for MOD and HM Treasury approval before negotiation with staff representatives. The outcome of negotiations is reported back to HM Treasury through the annual outturn statement.

The DSG Pay Strategy is approved by the DSG Board and Remuneration Committee and is designed to achieve the Corporate Business Strategy having due regard to the financial success of DSG, current Government and MOD policies and targets, and public sector pay guidance.

Performance Pay for SCS is dependent firstly on DSG meeting agreed Key Targets at a corporate level and then on individuals meeting agreed targets cascaded from the Corporate Plan. Achievement is determined by individual assessment within the line management chain.

Pay and changes to conditions of services are approved by the DSG Board and Remuneration Committee prior to the commencing the pay negotiating process with the Trades Unions and then reviewed after implementation.

All pay awards are subject to the satisfactory performance of the duties assigned.

SERVICE CONTRACTS OF DIRECTORS

Directors who are substantive members of the SCS hold appointments that are open-ended and made in accordance with the Civil Service Commissioner's Recruitment Code. This requires appointment to be on merit and based on fair and open competition, but also includes the circumstances when appointments may otherwise be made. Further information about the work of the Civil Service Commissioners can be found at www.civilservicecommission.org.uk. Members of the SCS recruited or promoted to the grade before 2 April 1990 have a 3 month notice period, members recruited or promoted to the grade after this time have a 1 month notice period.

Early termination of an executive director's appointment, other than for misconduct, would result in the individual receiving compensation as set out in the Civil Service Compensation Scheme. Details of the Civil Service Compensation Scheme can be found at www.civilservice-pensions.gov.uk.

Archie Hughes was appointed as Chief Executive of DSG on a fixed term contract which is due to expire in July 2011. Compensation for early termination, other than for misconduct, would be in accordance with the Civil Service Compensation Scheme.

Richard Atkinson was appointed on a temporary basis as acting Commercial Director on 1 October 2009 until 31 May 2010 and now continues in a senior commercial role as a Civil Service employee.

David Morgan was appointed as Commercial Director on 1 June 2010 on a fixed term contract which is due to expire on 31 May 2014. Compensation for early termination, other than for misconduct, would be in accordance with the Civil Service Compensation Scheme.

Independent Non-Executive Directors are appointed for a fixed term and are not appointed as civil servants. Contracts may be terminated at one month's notice by either party or on dissolution of the Board unless found guilty of gross misconduct when termination will be immediate. Their contracts may be extended by mutual agreement.

Remuneration for Non-Executive Directors is set at a fixed annual rate determined by the Department's Permanent Under Secretary. Fees are set on the basis that the role should require around 40 days work per year. This excludes the Non-Executive Director representing the interests of the MOD's Finance Director whose services are not charged to DSG. Non-Executive Directors are not involved in any discussion about their own remuneration and all payments made are non-pensionable. There are no compensation entitlements for early termination.

REMUNERATION DETAILS OF DIRECTORS (AUDITED)

Executive Directors	**2010/11** Salary and allowances[1] £'000	Performance Bonus £'000	**2009/10** Salary and allowances[1] £'000	Performance Bonus[3] £'000
Archie Hughes Chief Executive[2]	155-160	85-90	155-160	35-40
John Reilly Chief Operating Officer[2]	105-110	5-10	100-105	5-10
Steve Hall Finance Director[2]	70-75	5-10	65-70	5-10
Derek Owen Human Resources Director[2]	85-90	5-10	85-90	5-10
David Morgan Commercial Director (from 1 June 2010)[2,4]	80-85	15-20	–	–
Keith Norris Strategy Director[3]	65-70	5-10	65-70	5-10
Richard Atkinson Commercial Director (to 31 May 2010)[5]	10-15	–	35-40	–

SALARY

1 Gross salary includes: salary; reserved rights to London Weighting or London allowances; recruitments and retention allowances; travel and subsistence allowances and any other allowance to the extent that it is subject to UK taxation.
2 Performance Bonuses are considered as part of the overall performance appraisal process, the outcome of which is not known until after the publication of the Annual Accounts. The value reported for this Executive Director reflects the estimated bonus in year for the individuals' performance for that same year which has been accrued at the maximum value payable.
3. The performance bonus value reported for this Executive Director reflects the actual bonus payable for the individuals' performance for that same year.
4 The full year equivalent salary for this appointment is £100k–105k per annum (not applicable in 2009/10).
5 The full year equivalent salary for this appointment is £75k–80k per annum (£75k–80k in 2009/10).

PENSION BENEFITS

	Accrued Pension at pension age as at 31/03/11 and related lump sum £'000	Real increase/ (decrease) in pension and related lump sum at pension age £'000	CETV at 31/03/11 £'000	CETV at 31/03/10[1] £'000	Real increase/ (decrease) in CETV £'000	Employee contribution to partnership pension account £'000
Archie Hughes	10-15	0-2.5	207	169	19	–
John Reilly	35-40 Plus lump sum of 105-110	(2.5)-0 Plus lump sum of (2.5)-0	763	711	(3)	–
Steve Hall	20-25 Plus lump sum of 60-65	0-2.5 Plus lump sum of 0-2.5	284	257	4	–
Derek Owen	35-40 Plus lump sum of 105-110	(2.5)-0 Plus lump sum of (2.5)-0	825	770	(6)	–
David Morgan (from 1 June 2010)	0-5	0-5	17	0	14	–
Keith Norris	25-30 Plus lump sum of 80-85	0-2.5 Plus lump sum of 0-2.5	571	515	12	–
Richard Atkinson (to 31 May 2010)	0-5	0-2.5	49	45	1	–

1 The figure may be different from the closing figure in last year's accounts. This is due to the CETV factors being updated to comply with The Occupational Pension Schemes (Transfer Values) (Amendment) Regulations 2008

CIVIL SERVICE PENSIONS

A Cash Equivalent Transfer Value (CETV) is the actuarially assessed capitalised value of the pension scheme benefits accrued by a member at a particular point in time. The benefits valued are the member's accrued benefits and any contingent spouse's pension payable from the scheme. A CETV is a payment made by a pension scheme or arrangement to secure pension benefits in another pension scheme or arrangement when the member leaves a scheme and chooses to transfer the benefits accrued in their former scheme. The pension figures shown relate to the benefits that the individual has accrued as a consequence of their total membership of the pension scheme, not just their service in a senior capacity to which disclosure applies.

The figures include the value of any pension benefit in another scheme or arrangement which the individual has transferred to the Civil Service pension arrangements. They also include any additional pension benefit accrued to the member as a result of their buying additional pension benefits at their own cost. CETVs are calculated in accordance with The Occupational Pension Schemes (Transfer Values) (Amendment) Regulations and do not take account of any actual or potential reduction to benefits resulting from Lifetime Allowance Tax which may be due when pension benefits are taken.

The real increase in CETV represents the amount that is funded by the employer. It does not include the increase in accrued pension due to inflation, contributions paid by the employee (including the value of any benefits transferred from another pension scheme or arrangement) and uses common market valuation factors for the start and end of the period.

Further details relating to the Civil Service pension arrangements can be found in Note 5 to these accounts and at the website www.civilservice-pensions.gov.uk.

None of the Directors have opted for a Partnership Account therefore there are no employer contributions to such accounts in respect of these Directors.

None of the Directors have received a payment for compensation for loss of office under the terms of an approved compensation scheme and no awards or compensation have been paid to former Directors.

None of the Directors have remuneration packages containing non-cash elements. No payments have been made to third parties for the services of a Director.

REMUNERATION DETAILS OF DIRECTORS (AUDITED)

Non-Executive Directors	Fees 2010/11 *£'000*	Fees 2009/10 *£'000*
Jamie Pike	35-40	35-40
David Barrass	15-20	15-20
Janet Baker (from 1 January 2010)	15-20	5-10
David Williams[1] (from 1 November 2010)	N/A	N/A
Terence Jagger[1] (to 29 October 2010)	N/A	N/A
Michael Jones (to 31 December 2009)	N/A	15-20

1 This position has been appointed in conjunction with its responsibilities at MOD. It is not entitled to receive separate remuneration in undertaking its DSG duties.

Approval

The Directors' Remuneration Report has been approved by the DSG Chief Executive.

Archie Hughes
Chief Executive
30 June 2011

THE CERTIFICATE AND REPORT OF THE COMPTROLLER AND AUDITOR GENERAL TO THE HOUSES OF PARLIAMENT

I certify that I have audited the financial statements of the Defence Support Group for the year ended 31 March 2011 under the Government Trading Funds Act 1973. These comprise the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Changes in Taxpayers' Equity, the Statement of Cash Flows and the related notes. These financial statements have been prepared under the accounting policies set out within them. I have also audited the information in the Remuneration Report that is described in that report as having been audited.

RESPECTIVE RESPONSIBILITIES OF THE DEFENCE SUPPORT GROUP AND ACCOUNTING OFFICER AND AUDITOR

As explained more fully in the Statement of the Accounting Officer's Responsibilities, the Defence Support Group and Accounting Officer are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. My responsibility is to audit, certify and report on the financial statements in accordance with the Government Trading Funds Act 1973. I conducted my audit in accordance with International Standards on Auditing (UK and Ireland). Those standards require me and my staff to comply with the Auditing Practices Board's Ethical Standards for Auditors.

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Defence Support Group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Defence Support Group; and the overall presentation of the financial statements. In addition I read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my certificate.

In addition, I am required to obtain evidence sufficient to give reasonable assurance that the expenditure and income reported in the financial statements have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

OPINION ON REGULARITY

In my opinion, in all material respects, the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

OPINION ON FINANCIAL STATEMENTS

In my opinion:

- the financial statements give a true and fair view of the state of the Defence Support Group's affairs as at 31 March 2011 and of its profit for the year then ended; and
- the financial statements have been properly prepared in accordance with the Government Trading Funds Act 1973 and HM Treasury directions issued thereunder.

OPINION ON OTHER MATTERS

In my opinion:

- the part of the Remuneration Report to be audited has been properly prepared in accordance with HM Treasury directions made under the Government Trading Funds Act 1973; and,
- the information given in the Statement by the Chief Executive, Business, Mission, Vision and Strategy; the Business Performance Review and Financial Performance Review sections included within the Annual Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

MATTERS ON WHICH I REPORT BY EXCEPTION

I have nothing to report in respect of the following matters which I report to you if, in my opinion:

- adequate accounting records have not been kept; or,
- the financial statements and the part of the Remuneration Report to be audited are not in agreement with the accounting records or returns; or,
- I have not received all of the information and explanations I require for my audit; or,
- the Statement on Internal Control does not reflect compliance with HM Treasury's guidance.

REPORT

I have no observations to make on these financial statements.

Amyas C E Morse
Comptroller and Auditor General
National Audit Office
157-197 Buckingham Palace Road
Victoria
London
SW1W 9SP
5 July 2011

STATEMENT OF COMPREHENSIVE INCOME FOR THE PERIOD ENDED 31 MARCH 2011

	Note	2010/2011 £'000	2009/2010 £'000
Turnover	2	209,062	232,554
Cost of sales	3	(184,926)	(197,804)
Gross profit		**24,136**	**34,750**
Administrative expenses	3	(16,630)	(22,101)
Operating profit		**7,506**	**12,649**
Large Aircraft business closure provision	13	694	(3,973)
Profit on ordinary activities before interest		**8,200**	**8,676**
Interest receivable		95	96
Interest payable	4	(1,359)	(1,435)
Profit on ordinary activities before dividend		**6,936**	**7,337**
Dividend payable		(2,300)	(4,500)
Net Income after interest and dividend		**4,636**	**2,837**
Other comprehensive Income/(Expenditure)			
Net gain/(loss) on revaluation of Property Plant & Equipment		46,649	(3,757)
Net gain/(loss) on revaluation of Inventories		(31)	3
Asset donations received during the year		2,034	253
Total comprehensive Income/(Expenditure) for the year		**53,288**	**(664)**
Return on capital employed (ROCE)		**7.99%**	**8.25%**

All operations reported above are continuing.
The notes on pages 44 to 61 form part of these accounts.

STATEMENT OF FINANCIAL POSITION AS AT 31 MARCH 2011

	Note	31 March 2011 £'000	31 March 2010 £'000
Non-current assets			
Property, Plant and Equipment	7	92,520	47,380
Total non-current assets		**92,520**	**47,380**
Current assets			
Inventories	8	14,943	27,396
Trade and other receivables	9	56,688	48,390
Cash and cash equivalents	10	36,090	34,567
Total current assets		**107,721**	**110,353**
Total assets		**200,241**	**157,733**
Current liabilities			
Trade and other payables	11	(46,015)	(54,691)
Loans	12	(1,664)	(1,664)
Provisions	13	(4,046)	(4,485)
Total current liabilities		**(51,725)**	**(60,840)**
Non-current liabilities			
Loans	12	(26,625)	(28,290)
Total non-current liabilities		**(26,625)**	**(28,290)**
Net assets		**121,891**	**68,603**
Financed by:			
Capital and reserves			
Public dividend capital		23,324	23,324
Revaluation reserve		66,332	20,180
Donated asset reserve		2,287	253
Retained earnings		29,948	24,846
Taxpayers' equity		**121,891**	**68,603**

The notes on pages 44 to 61 form part of these accounts.

Archie Hughes
Chief Executive
30 June 2011

The above date is the due date authorised for issue, being the date of despatch by the Trading Fund's Board, to the Comptroller and Auditor General, for laying before the Houses of Parliament.

STATEMENT OF CASH FLOWS FOR THE PERIOD ENDED 31 MARCH 2011

	Note	2010/2011 £'000	2009/2010 £'000
Cash flows from operating activities			
Operating profit	statement of comprehensive income	7,506	12,649
Adjustments for:			
Losses on disposals of non-current assets	7	91	59
Permanent diminution of non-current assets	7	1,541	464
Depreciation charges		2,092	2,536
(Increase)/decrease in Large Aircraft closure costs	13	694	(3,973)
Decrease/(increase) in inventories	8	12,422	(2,031)
Increase in receivables	9	(8,298)	(925)
Decrease in payables	11	(6,476)	(17,897)
(Decrease)/increase in provisions for liabilities and charges	13	(439)	3,930
Net cash inflow/(outflow) from operating activities		**9,133**	**(5,188)**
Cash flows from investing activities			
Payments to acquire property plant and equipment	14a	(181)	(1,337)
Receipts for sale of non current assets		-	90
Interest received	14a	95	96
Net cash (outflow) from investing activities		**(86)**	**(1,151)**
Cash flows from financing activities			
Decrease in borrowings	14a	(1,665)	(1,665)
Dividends paid	statement of comprehensive income	(4,500)	-
Interest paid	14a	(1,359)	(1,435)
Net cash (outflow) from financing activities		**(7,524)**	**(3,100)**
Increase/(Decrease) in cash and cash equivalents	**14b**	**1,523**	**(9,439)**
Cash and cash equivalents at start of year	14b	34,567	44,006
Cash and cash equivalents at end of year	14b	36,090	34,567

The notes on pages 44 to 61 form part of these accounts.

STATEMENT OF CHANGES IN TAXPAYERS' EQUITY FOR THE YEAR ENDED 31 MARCH 2011

	Public Dividend Capital	Revaluation Reserve	Donated Asset Reserve	Retained Earnings	Total Equity
	£'000	*£'000*	*£'000*	*£'000*	*£'000*
Taxpayers' equity at 31 March 2009	**23,324**	**27,294**	**–**	**18,649**	**69,267**
Comprehensive income for the year	–	(3,754)	253	2,837	(664)
Realised element of revaluation reserve	–	(3,360)	–	3,360	0
Taxpayers' equity at 31 March 2010	**23,324**	**20,180**	**253**	**24,846**	**68,603**
Comprehensive income for the year	–	46,618	2,034	4,636	53,288
Realised element of revaluation reserve	–	(466)	–	466	0
Taxpayers' equity at 31 March 2011	**23,324**	**66,322**	**2,287**	**29,948**	**121,891**

The notes on pages 44 to 61 form part of these accounts.

NOTES TO THE ACCOUNTS FOR THE YEAR ENDED 31 MARCH 2011

1 ACCOUNTING POLICIES

Basis of accounting

The accounts have been prepared in accordance with the Government Financial Reporting Manual (FReM) for 2010/11 and the Accounts Direction, both issued by HM Treasury. The accounting policies contained in the FReM apply International Financial Reporting Standards (IFRS) as adapted or interpreted for the public sector context. Where the FReM permits a choice of accounting policy, the accounting policy which is judged to be most appropriate to the particular circumstances of DSG for the purpose of giving a true and fair view has been selected. The particular policies adopted by DSG are described below. They have been applied consistently in dealing with items considered material in relation to the accounts.

Going Concern

In autumn 2010 the MOD's Strategic Defence and Security Review (SDSR) announced that DSG would be one of the MOD owned assets which would be offered for sale. The options for sale are currently being considered by the MOD and the decision as to how and when DSG is sold has yet to be made. The Chief Executive as accounting officer has considered the impact of the announcement on DSG's ability to continue as a going concern. In his view, whilst there remains uncertainty about the future ownership of the organisation, this will not have any affect on the operation of the organisation for at least the next 12 months. Therefore the financial statements have been prepared on a going concern basis.

Accounting convention

These accounts have been prepared in accordance with the accruals concept and the historical cost convention, modified to account for the revaluation of land and buildings and other non current assets, at current costs or value to the business.

Turnover

Turnover comprises the invoiced and accrued value of services (excluding VAT and other sales taxes) and is recognised in line with the underlying sales contract which may result in turnover and costs declared prior to job completion.

Property, Plant and Equipment

Basis of Valuation

Property Plant and Equipment are carried at fair value. A professional quinquennial valuation, in accordance with the Royal Institute of Chartered Surveyors Appraisal and Valuation Standards Red Book, was carried out by GVA Grimley Ltd as at 31 March 2011. Due to the nature of the business assets a market valuation is difficult to determine therefore the basis of valuation applied is generally either Depreciated Replacement Cost or Existing Use.

Property, Plant and Equipment is revalued in the years between professional valuations, using the Corporate Financial Controller (CFC) Modified Historic Cost Accounting (MHCA) indices produced by the Defence Analytical Services Agency (DASA), and is carried at valuation as at the end of the accounting period.

Land and buildings

Where DSG is the principal beneficial user of Departmental Estate, such estate is treated as an asset of the Agency although legal ownership rests with the Secretary of State for Defence.

Other property, plant and equipment

Plant, equipment, computers and transport equipment are capitalised where the useful life exceeds one year and the cost of acquisition exceeds £10,000 excluding VAT. The value of capitalised plant, equipment and transport equipment is reviewed annually and adjustments made using the CFC MHCA Index in the relevant periods.

Depreciation

Freehold land is not depreciated. Depreciation on buildings, plant and equipment, transport equipment and IT equipment is calculated to reflect the consumption of economic benefit of assets by equal instalments over their estimated useful lives. The lives of the assets are periodically reviewed for with reference to obsolescence and continued asset useage.

The depreciation rates applied to the main categories of assets are based on the following estimates of useful life.

Buildings	Not exceeding sixty years
Plant & Equipment	Between three and twenty years
Motor Vehicles	Between three and twenty years
IT Equipment	Between three and ten years

Where an impairment loss has occurred with reference to the existing use of an asset, a discount rate of 3.5% has been applied to the cashflows.

Pension costs

Past and present employees are covered by the provisions of the Principal Civil Service Pension Scheme (PCSPS) and Armed Forces Pension Schemes (AFPS) which is non-contributory and unfunded. Although the scheme is a defined benefit scheme, liability for payment of future benefits is a charge to the PCSPS or AFPS appropriately. The cost of pension cover provided is by payments of charges (Accrued Superannuation Liability Charges – ASLC) based on a percentage of salary. Salaries include gross salary, certain performance bonuses and recruitment and retention allowances. It does not include the estimated monetary value of benefits in kind. Payments are made at contribution rates determined by the Government Actuary's Department.

Foreign exchange

All foreign denominated transactions are translated at the average exchange rate for the previous month, being a proxy rate for that ruling at the time of the transaction. At 31 March balances are translated into sterling at a year end spot rate. Foreign exchange differences are taken directly to the Statement of Comprehensive Income.

Inventories

Inventory is valued at current cost, being the amount of cash or cash equivalents that would have to be paid if the same or equivalent inventory was acquired at the date of the Statement of Financial Position. Following periodic reviews, provisions are made to cover obsolescent, surplus or defective items.

Where provision is made is it based on 100% provision against the value of the appropriate items. This calculation can include any significant surplus inventories based on projected consumption using historical trends.

Work in progress

Work in progress is valued on the basis of direct labour and indirect production support, plus those business overheads that are directly related to normal levels of production activity. For spares inclusive contracts, the cost of the spares consumed is also included in the WIP valuation. The value is reviewed monthly to reflect the lower of cost or net realisable value and the rates used to value WIP are reviewed at least annually.

Long-term contracts

Long term contract (LTC) balances are stated at costs incurred (net of amounts transferred to cost of sales), after deducting related payments on account. Profit on individual long term contracts is taken only when their outcome can be foreseen with reasonable certainty, based on the lower of the percentage margin earned to date and that prudently forecast at completion, taking account of agreed claims. Turnover on long term contracts is ascertained in a manner appropriate to the stage of completion of the contract.

At the point any contract is foreseen to become loss making a provision will be made for the future losses identified. Other provisions represent liabilities of uncertain timing or amount. Provisions are discounted where the effect of the discount would be material.

Provision for bad and doubtful debts

DSG makes provision for bad and doubtful debts as soon as they are deemed to be irrecoverable based on analysis and reviews of aged receivables.

Operating leases

Rentals under operating leases are charged to the Statement of Comprehensive Income as incurred.

Return on capital employed

The return on capital employed is expressed as the profit before interest for the year as a percentage of the average capital employed during the year. Capital employed comprises the total net assets (non-current assets at net book value, plus current assets, less current liabilities, less non current liabilities) and adding back the short and long term loans provided from government sources.

Value Added Tax

DSG has a single registration for VAT with HM Revenue & Customs and accounts for VAT on an accruals basis.

Employee benefits

DSG accrues for untaken employee leave entitlement at the end of the financial year. For permanent employees the leave year runs to 30 April and employees are able to carry forwards an element of entitlement at the end of the financial year. These amounts fall due within one year and the value of the liability is calculated using records of actual untaken leave and average pay rates to comply with IAS 19.

Significant accounting judgements and estimates

DSG management makes judgements and assumptions concerning the future that impact the application of policies and reported amounts. The resulting accounting estimates calculated using these judgements and assumptions will, by definition, seldom equal the related actual results but are based on historical experience and expectations of future events. The judgements and key sources of estimation uncertainty that have a significant effect on the amounts recognised in the financial statements are discussed below.

Provisions have been made for the closure of the Large Aircraft business and any associated employment issues, for future costs due to the implementation of the current redundancy programme and obsolete stock. These provisions are estimates and the actual costs and timing of future cash flows are dependent on future events. Any difference between expectations and the actual future liability will be accounted for in the period when such determination is made.

Accruals for the costs of goods and services received are recognised based on the best information available at the reporting date. Accruals include significant balances related to reimbursement for utilities payable to the MOD. Any difference between accounting accruals and the actual liability when presented will be accounted for in the period when such determination is made.

CFC Indexation rates for the Quinquennial Non Current Asset Review are provided by the Corporate Financial Controller (CFC) for revaluing non current assets under the Modified Historic Cost Accounting (MHCA) regime. Whilst these indices predict a valuation as at the end of the accounting period they include corrections for previous periods. In these accounts, DSG has applied the professional external revaluations of its non current assets from GVA Grimley at as 31 March 2011.

Inventory revaluation reserve realisation, DSG uses standard costing to value its inventory but, where the standards are subject to annual or periodic revaluation, does not track on an item by item basis the realisation of this revaluation. The realisation is accounted for by applying an aged inventory analysis to the inventory revaluation reserve.

IFRSs, amendments and interpretations in issue but not yet effective or adopted

IAS8 requires disclosures in respect of new IFRSs, amendments and interpretations that are, or will be applicable after the reporting period. There are a number of IFRSs, amendments and interpretations that have been issued by the International Accounting Standards Board that are effective for future reporting periods. The following have not been adopted early by DSG:

IFRS1 First-time adoption of international financial reporting standards Two sets of amendments to the existing standard.

IFRS3 Business Combinations Amendments to the existing standard.

IFRS7 Financial Instruments: Disclosures Two sets of amendments to the existing standard.

IFRS9: Financial Instruments A new standard intended to replace IAS39.

IAS1 Presentation of Financial Statements Minor amendment to the existing standard.

IAS27 Consolidated and Separate Financial Statements Amendments to the existing standard.

IAS34 Interim Financial Reporting Amendments to the existing standard.

IFRIC13 Customer Loyalty Programmes Minor clarification to the existing interpretation.

IFRIC14 Prepayments of a Minimum Funding Requirement Amendments to the existing interpretation.

IFRIC19 Extinguishing Financial Liabilities with Equity Instruments A new interpretation.

None of these new or amended standards and interpretations are likely to be applicable or are anticipated to have a future material impact on the financial statements of DSG.

2 TURNOVER AND SEGMENTAL ANALYSIS

Turnover is stated net of trade discounts, provisions, VAT and similar taxes. There were no acquisitions or discontinued operations with the majority of turnover arising from UK sources.

Where the substance of the transaction is such that DSG effectively operates as an agent, turnover represents the net revenue receivable.

Although substantially all turnover relates to the same class of business: the repair, overhaul and maintenance of equipment, DSG is able to analyse its operating profit by activity depending on the type of equipment platform being worked on.

The major segments are Land platforms, Air and Electronic platforms and specialist procurement and supply operation carried out by the Land Supply business.

An amount of £505k relating to prior year turnover has been recognised in year following the agreement of cost certificates. The previous treatment of this item was based on the best information at the time and therefore this is not an error, just the correction of an estimate.

Analysis of turnover and operating profit by these segments for the year ended 31 March 2011:

	Land	**Air and Electronics**	**Land Supply**	**Total**
2010/2011	*£'000*	*£'000*	*£'000*	*£'000*
Turnover (i)	143,414	53,149	12,499	209,062
Cost of Sales	135,273	42,576	8,992	184,926
Administrative expenses	11,116	3,342	257	16,630
Operating profit	**(2,975)**	**7,231**	**3,250**	**7,506**

(i) Within turnover £184.328m relates to MOD customers.

2009/2010				
Turnover	164,152	56,638	11,764	232,554
Cost of Sales	143,620	44,742	9,442	197,804
Administrative expenses	14,257	6,544	1,300	22,101
Operating profit	**6,275**	**5,352**	**1,022**	**12,649**

3 COST OF SALES AND OPERATING EXPENSES

	Note	2010/11 £'000	2009/10 £'000
Cost of sales:			
Staff costs (i)	5b	104,319	107,416
Supplies and services consumed (i)		73,554	76,984
Accommodation costs		5,537	10,452
Depreciation and impairment		3,388	2,766
Cost reimbursement (ii)		(6,104)	(4,787)
Other administration costs (i)	6	4,232	4,973
Total cost of sales		**184,926**	**197,804**
Operating expenses:			
Staff costs (i)	5b	6,735	11,189
Supplies and services consumed (i)		665	1,173
Accommodation costs		256	827
Depreciation and impairment		193	279
Other administration costs (i)	6	8,781	8,633
Total operating expenses		**16,630**	**22,101**
Cost of sales & operating expenses:			
Staff costs (i)	5b	111,054	118,605
Supplies and services consumed (i)		74,219	78,157
Accommodation costs		5,793	11,279
Depreciation and impairment		3,581	3,045
Cost reimbursement (ii)		(6,104)	(4,787)
Other administration costs (i)	6	13,013	13,606
Total cost of sales & operating expenses		**201,556**	**219,905**

(i) The following amounts relating to prior year expenditure have been recognised in year, the previous treatment was based on the best information at the time and therefore these are not errors, just correction of estimates.Relating to an increase in cost of sales, £510k of WIP costs not recoverable through sales and £372k of purchase order receipting accruals in goods received not invoiced have been cleansed.

(ii) Cost reimbursement primarily relate to MOD and Welsh Assembly Government contributions to St Athan airfield running costs (£2,328k in 2010/11 and £2,357k in 2009/10), the MOD funding of the Large Aircraft hanger relocation (£3,073k in 2010/11 and £1,444k in 2009/10) and various facility management and other costs recharged to units lodging on DSG sites (£703k in 2010/11and £986k in 2009/10). These are shown separately to assist visibility.

4 INTEREST PAYABLE AND SIMILAR CHARGES

	2010/11 £'000	2009/10 £'000
On loans wholly repayable within five years	–	–
On loans not wholly repayable within five years	1,359	1,435
	1,359	**1,435**

5 STAFF NUMBERS AND COSTS

	2010/11	2009/10
(a) Staff Numbers	Number of employees	Number of employees
The average number of persons employed during the year was:		
Senior Management	6	6
Service personnel	20	20
Civilian personnel	3,136	3,334
Agency staff	120	236
	3,282	3,596
(b) Payroll Costs	*£'000*	*£'000*
in Cost of sales:		
Salaries, wages and allowances	80,811	82,056
Social security	5,970	5,505
Pension costs	13,788	12,598
Agency Staff	3,750	7,257
	104,319	107,416
	£'000	*£'000*
in Operating expenses:		
Salaries, wages and allowances	4,579	8,321
Social security	450	758
Pension costs	978	1,039
Agency Staff	728	1,071
	6,735	11,189
	£'000	*£'000*
Total:		
Salaries, wages and allowances	85,390	90,377
Social security	6,420	6,263
Pension costs	14,766	13,637
Agency Staff	4,478	8,328
Total payroll costs	**111,054**	**118,605**

5 STAFF NUMBERS AND COSTS (CONTINUED)

(c) Pension benefits for civilian employees are provided through the Civil Service Pension arrangements. From 1 October 2002, civil servants may be in one of three statutory based 'final salary' defined benefit schemes (Classic, Premium and Classic Plus). The schemes are unfunded, with the cost of benefits met by monies voted by Parliament each year. Pensions payable under Classic, Premium and Classic Plus are increased annually in line with changes in the Retail Prices Index. New entrants between 1 October 2002 and 30 July 2007 could choose between membership of Premium or joining a good quality 'money purchase' stakeholder arrangement with a significant employer contribution (partnership pension account). New entrants from 30 July 2007 may choose only between a partnership pension and the 'Nuvos' occupational pension scheme.

Employee contributions are set at the rate of 1.5% of pensionable earnings for Classic and 3.5% for Premium, Classic Plus and Nuvos. Benefits in Classic accrue at the rate of 1/80th of pensionable salary for each year of service. In addition, a lump sum equivalent to three years' pension is payable on retirement. For Premium, benefits accrue at the rate of 1/60th of final pensionable earnings for each year of service. Unlike Classic, there is no automatic lump sum (but members may give up (commute) some of their pension to provide a lump sum). Classic Plus is essentially a variation of Premium, but with benefits in respect of service before 1 October 2002 calculated broadly as per Classic. Benefits in Nuvos accrue at the rate of 2.3% of pensionable earnings towards members pensions annually, to a maximum of 75% of final salary.

The partnership pension account is a stakeholder pension arrangement. Employers' contributions are age-related and range from 3% to 12.5% of pensionable pay into a stakeholder pension product chosen by the employee. The employee does not have to contribute but where they do make contributions, the employer will match these up to a limit of 3% of pensionable salary (in addition to the employer's basic contribution).

Employers also contribute a further 0.8% of pensionable salary to cover the cost of centrally provided risk benefit cover (death in service and ill health retirement).

The Principal Civil Service Pension Scheme (PCSPS) is an unfunded defined benefit scheme and it is not possible to separately identify DSG's share of the underlying assets and liabilities. A full actuarial valuation was carried out as at 31 March 2007. Details can be found in the resource accounts of the Cabinet Office: Civil Superannuation (www.civilservice-pensions.gov.uk). For 2010-11 employers' contributions of £14,805,942 were payable to the PCSPS (2009-10 £13,649,823) at one of four rates in the range 16.7% to 24.3% of pensionable pay, based on salary bands.

The Scheme's Actuary reviews employer contributions usually every four years, following a full scheme valuation. The contribution rates are set to meet the cost of the benefits accruing during 2010-11 to be paid when the member retires and not the benefits paid during this period to existing pensioners. Similarly, employers' contributions to the Armed Forces Pension Scheme (AFPS) are determined by the Government Actuary's Department at a rate of 36.3% for Officers and 21.8% for other ranks. A valuation of the scheme liabilities of the AFPS was carried out in 2009/10.

For 2010/2011 employers' contributions of £50,395 were paid to one or more of a panel of four appointed stakeholder pension providers (2009/10: £53,625). In addition employer contributions of £3,545 were payable to the PCSPS to cover the cost of the future provision of lump sum benefits on death in service and ill health retirement of these employees (2009/10 £3,725). Contributions due to the partnership pension providers at the statement of financial position date were £4,322 (2009/10: £6,154).

10 employees retired early on ill-health grounds; the total additional accrued pension liabilities in the year amounted to £23,835 (2009/10 6 persons – additional pension liabilities amounted to £19,619).

5 STAFF NUMBERS AND COSTS (CONTINUED)

(d) Reporting of Civil Service and other compensation schemes - exit packages

Exit costs are accounted for in full in the year of departure except for the annual compensation costs of certain packages which fall into future years and are accounted for in the year of payment.

Comparative data shown in brackets for 2009/10.

Exit package cost band	Number of compulsory redundancies		Number of other departures agreed		Total number of exit packages by cost band	
<£10,000	0	(0)	1	(2)	1	(2)
£10,000 - £25,000	0	(0)	12	(5)	12	(5)
£25,000 - £50,000	0	(0)	32	(10)	32	(10)
£50,000 - £100,000	0	(0)	68	(19)	68	(19)
£100,000 - £150,000	0	(0)	34	(6)	34	(6)
£150,000 - £200,000	0	(0)	4	(15)	4	(15)
£200,000 - £250,000	0	(0)	0	(3)	0	(3)
£250,000 - £300,000	0	(0)	0	(2)	0	(2)
Total number of exit packages for in year departures	**0**	**(0)**	**151**	**(62)**	**151**	**(62)**
Total cost of in year departures £'000	**0**	**(0)**	**11,143**	**(6,345)**	**11,143**	**(6,345)**

Redundancy and other departure costs have been paid in accordance with the provisions of the Civil Service Compensation Scheme, a statutory scheme made under the Superannuation Act 1972. Exit costs are funded directly by the MOD and therefore are not accounted for in DSG.

Where early retirements have been agreed, the additional costs are met by DSG and not by the Civil Service pension scheme. Ill-health retirement costs are met by the pension scheme and are not included in the table.

6 OTHER ADMINISTRATION COSTS

	2010/11	2009/10
in Cost of sales:	£'000	£'000
Travel and subsistence, including vehicle hire	2,272	3,328
IT and telecommunications	808	(122)
Training, recruitment and consultancy	602	1,043
Insurance	50	8
Other expenses	812	756
Movement in provisions	(312)	(40)
	4,232	**4,973**

in Operating expenses:	£'000	£'000
Auditors' remuneration (i)	95	109
Travel and subsistence, including vehicle hire	636	882
IT and telecommunications	4,324	3,761
Training, recruitment and consultancy	1,533	1,983
Insurance	1,162	1,116
Other expenses	311	647
Losses/ (Gains) on Foreign Exchange	21	(36)
Movement in provisions	699	171
	8,781	**8,633**

Total:	£'000	£'000
Auditors' remuneration (i)	95	109
Travel and subsistence, including vehicle hire	2,908	4,210
IT and telecommunications	5,132	3,639
Training, recruitment and consultancy	2,135	3,026
Insurance	1,212	1,124
Other expenses	1,123	1,403
Gains on Foreign Exchange	21	(36)
Movement in provisions	387	131
Total of Other administration costs	**13,013**	**13,606**

(i) Including fees of £9k for 2009/10 only relating to IFRS transition.

7 PROPERTY, PLANT AND EQUIPMENT

The movements in each class of assets during 2010/11 were:

	Land £'000	Buildings £'000	Plant and Machinery £'000	Transport Equipment £'000	IT £'000	Assets in course of construction £'000	Total Tangible £'000
Cost or valuation:							
At 31 March 2010	13,948	70,384	20,055	652	1,522	1,105	107,666
Additions	–	–	15	–	–	165	180
Donations	–	–	–	–	–	2,034	2,034
Disposals	–	–	(353)	–	(622)	–	(975)
Permanent diminutions in value	–	(700)	(781)	–	(15)	–	(1,496)
Reclassification	2,986	(2,553)	300	–	30	(798)	(35)
Revaluation	9,325	(7,029)	(2,247)	(358)	(651)	–	(960)
At 31 March 2011	**26,259**	**60,102**	**16,989**	**294**	**284**	**2,506**	**106,414**
Depreciation:							
At 31 March 2010	–	42,250	16,365	363	1,308	–	60,286
Depreciation charged during the year	–	1,110	772	35	176	–	2,093
Disposals	–	–	(258)	–	(627)	–	(885)
Permanent diminutions in value	–	–	10	–	–	–	10
Reclassification	–	–	–	–	–	–	–
Revaluation	–	(43,360)	(3,002)	(398)	(850)	–	(47,610)
At 31 March 2011	**–**	**–**	**13,887**	**–**	**7**	**–**	**13,894**
Net book value:							
At 31 March 2011	**26,259**	**60,102**	**3,102**	**294**	**257**	**2,506**	**92,520**
At 31 March 2010	13,948	28,134	3,690	289	214	1,105	47,380
Asset financing:							
Owned	26,259	60,102	3,102	294	257	219	90,233
Donated	–	–	–	–	–	2,287	2,287
NBV as at 31 March 2011	**26,259**	**60,102**	**3,102**	**294**	**257**	**2,506**	**92,520**

7a PROPERTY, PLANT AND EQUIPMENT

The movements in each class of assets during 2009/10 were:

	Land	Buildings	Plant and Machinery	Transport Equipment	IT	Assets in course of construction	Total Tangible
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Cost or valuation:							
At 31 March 2009	16,967	77,373	19,787	590	1,528	411	116,656
Additions	–	222	259	31	54	1,024	1,590
Donations	–	–	–	–	–	–	–
Disposals	–	–	(420)	–	–	–	(420)
Permanent diminutions in value	(207)	(209)	(38)	–	(14)	–	(468)
Reclassification	–	286	9	–	32	(330)	(3)
Revaluation	(2,812)	(7,288)	458	31	(78)	–	(9,689)
At 31 March 2010	**13,948**	**70,384**	**20,055**	**652**	**1,522**	**1,105**	**107,666**
Depreciation:							
At 31 March 2009	–	47,020	15,492	267	1,181	–	63,960
Depreciation charged during the year	–	1,372	793	82	287	–	2,534
Disposals	–	–	(271)	–	–	–	(271)
Permanent diminutions in value	–	–	–	–	–	–	–
Reclassification	–	–	–	–	–	–	–
Revaluation	–	(6,142)	351	14	(160)	–	(5,937)
At 31 March 2010	**–**	**42,250**	**16,365**	**363**	**1,308**	**–**	**60,286**
Net book value:							
At 31 March 2010	**13,948**	**28,134**	**3,690**	**289**	**214**	**1,105**	**47,380**
At 31 March 2009	16,967	30,353	4,295	323	347	411	52,696
Asset financing:							
Owned	13,948	28,134	3,690	289	214	1,105	47,380
NBV as at 31 March 2010	**13,948**	**28,134**	**3,690**	**289**	**214**	**1,105**	**47,380**

8 INVENTORIES

	31 March 2011		31 March 2010	
	£'000	£'000	£'000	£'000
Gross Inventories	15,810		15,882	
Less inventory provision	(2,635)		(1,400)	
		13,175		14,482
Work in progress – net costs incurred		1,768		12,914
Total inventories		**14,943**		**27,396**

During 2010/11, inventory with a value of £34.822m was charged to cost of sales along with the creation of an additional £2.217m of inventory provision and £0.982m of inventory write down. During the same period, £107.694m of work in progress was expensed to cost of sales along with £0.510m of work in progress which was written down.

9 RECEIVABLES AND PREPAYMENTS

	31 March 2011	31 March 2010
	£'000	£'000
Trade and sundry invoiced receivables	52,901	41,248
Other receivables	674	1,171
Bad debt provision	(209)	(113)
Prepayments and accrued income	3,322	6,084
	56,688	**48,390**

Current assets are further analysed by debtor category as noted below:

	31 March 2011	31 March 2010
	£'000	£'000
Other central government bodies	48,550	37,783
Local authorities	–	359
Bodies external to government	8,138	10,248
	56,688	**48,390**

All the above balances fall due within 1 year.

Aged Trade and Sundry Invoiced Receivables Analysis	**Not Yet Due**	**30 to 60 Days**	**60 to 90 Days**	**90 to 120 Days**	**120 Days +**	**Total**
	£'000	£'000	£'000	£'000	£'000	£'000
At 31 March 2011	44,834	4,187	1,219	1,055	1,606	52,901
At 31 March 2010	30,752	7,712	1,902	203	679	41,248

10 CASH AT BANK AND IN HAND

	31 March 2011	31 March 2010
	£'000	£'000
Cash on short term deposit and at bank (i) (ii)	36,083	34,560
Cash in hand	7	7
	36,090	**34,567**

(i) Wherever possible cash is held in interest earning accounts, which are redeemable on demand within one working day.
(ii) Other than cash in hand all deposits and balances were held within a commercial bank.
An analysis of change in net funds can be found at note 14(b).

11 PAYABLES

Amounts falling due within one year:	31 March 2011	31 March 2010
	£'000	£'000
Trade payables (i)	1,132	2,957
Taxation and social security	2,226	2,088
Value Added Tax	8,416	3,035
Accruals	16,567	29,936
Dividend payable	2,300	4,500
Deferred income	11,514	6,225
Sundry payables	3,860	5,950
	46,015	**54,691**

Payables are further analysed by creditor category as below:

	£'000	£'000
Other central government bodies	17,526	22,821
Bodies external to government	28,489	31,870
	46,015	**54,691**

(i) DSG aims to pay its suppliers within contracted payment terms or general conditions governing the terms for the type of business undertaken or, in the absence of specially agreed terms, within 30 days of receipt of a valid invoice. Measured against direction from HM Treasury for 2010/11, 90% of invoices were paid within a 5 day target and 96% were paid within a 10 day target.

12 SHORT TERM AND LONG TERM LOANS

	31 March 2011	31 March 2010
	£'000	£'000
Current portion of long term borrowings	1,664	1,664
Loan repayments due within 2 and 5 years	6,656	6,657
Loan repayments due after 5 years	19,969	21,633
	28,289	**29,954**

13 PROVISIONS FOR LIABILITIES AND CHARGES

	Revenue Provision	Other	Large Aircraft Closure	Total
	£'000	£'000	£'000	£'000
Balance at 1 April 2010	23	489	3,973	4,485
Increase in provisions	–	1,056	(694)	362
Utilised in year	–	(210)	(591)	(801)
Balance at 31 March 2011	**23**	**1,335**	**2,688**	**4,046**

Revenue Provision

This provision arises out of an obligation to pay damages to a customer in respect of equipment damage caused by DSG. The calculation is based on DSG's best estimate of the value of the equipment damaged and the liabilities and charges provided for are expected to fall due within one year.

Large Aircraft Closure Provision

On 29 March 2010 the then Secretary of State for Defence, Bob Ainsworth, laid before Parliament a Written Ministerial Statement about Defence Equipment, which concluded with a statement confirming the intention to close the LABU facility at St Athan by June 2013 at the latest. The costs of redundancy are funded directly by the MOD (see below) – this provision has been created to cover the other costs arising from this closure.

Whilst the major production line ceased in December 2010, DSG will continue to operate these facilities until the minor production stream ends during 2012/13. At this final point DSG will abandon the facilities and the business will be treated as discontinued.

Expenditure has been charged against this provision as incurred from 1 April 2010 and will continue until the closure date and is primarily related to the costs of cleaning up the site and supporting the costs associated with a proportion of mobile grade employees remaining in the redeployment pool.

Other Provisions

These provisions are to meet a variety of obligations including primarily the costs associated with the implementation of the current redundancy program and the liabilities and charges provided for are expected to fall due within one year.

The MOD has confirmed that it will continue to meet any liabilities in respect of DSG's redundancy costs and, accordingly with the exception of the implementation cost above, no further provision has been made for these future liabilities in these accounts.

	2011/12	2012/13	2013/14
	£'000	£'000	£'000
Large Aircraft Closure Provision Utilisation	764	1,547	377

14 CASH FLOW STATEMENT NOTE

(a) Detailed analysis of gross cash flows

	2010/2011	2009/2010
	£'000	£'000
Returns on investments and servicing of finance		
Interest received	95	96
Interest paid	(1,359)	(1,435)
	(1,264)	(1,339)
Capital expenditure		
Non current assets in the course of construction	(2,199)	(1,024)
Less assets donated	2,033	253
Purchase of non current assets	(15)	(566)
	(181)	(1,337)
Financing		
With the MOD:		
Decrease in borrowings	(1,665)	(1,665)
	(1,665)	(1,665)

(b) Analysis of changes in net funds/(debt)

	At 31 March 2010	Cashflow	At 31 March 2011
	£'000	£'000	£'000
Cash at bank and in hand	34,567	1,523	36,090
Debt due within one year	(1,664)	–	(1,664)
Debt due after one year	(28,290)	1,665	(26,625)
Total	**4,613**	**3,188**	**7,801**

(c) Analysis of changes in cash and cash equivalents

	£'000
Balance at 31 March 2010	**34,567**
Net change in cash and cash equivalent balances	1,523
Balance at 31 March 2011	**36,090**

15 OPERATING LEASES

Operating Lease payments recognised as expenses in the period were:

	2010/2011	2009/2010
	£'000	*£'000*
Lease of buildings at RAF St Athan (i)	307	281
Lease of vehicles & Other Equipment (ii)	412	697
Total operating leases paid	**719**	**978**

(i) Contained within note 3 – Accommodation costs.
(ii) Contained within note 6 – Vehicle hire, and Other expenses and within note 3 – Supplies and services consumed.
None of these payments were contingent rents or sublease payments.

Future minimum lease payments under non-cancellable operating leases are due as follows:

	31 March 2011	31 March 2010
	£'000	*£'000*
Not later than one year	622	688
Later than one year and not later than five years	358	642
Later than five years	–	–
	980	**1330**

DSG has only one lease of significance, this relates to the lease of a building on the St Athan site which commenced on 1 April 2010 and runs for 118 years with 10 year breaks. It has been agreed between DSG, Defence Estates (DE) representing the MOD and the Welsh Assembly Government that when DSG vacates the site the DE will take over responsibilty for the lease.

None of DSG's leasing arrangements have renewal or purchase options, rentals are payable on fixed instalments over the duration of the lease.

There are no restrictions imposed by lease arrangements on dividends or further debt.

Future minimum lease payments under non-cancellable operating leases where DSG is acting as lessor are:

	£'000
Receivable within one year	258
Receivable after one year	–
	258

This relates to a short term lease on facilities at the Sealand site.

There are no finance leases.

16 COMMITMENTS, CONTINGENT ASSETS AND LIABILITIES

Whilst not yet committed, £963k of capital expenditure has been authorised but not provided for in the accounts as at 31 March 2011 (2010 £619k). Capital commitments of £25k existed and were not provided for as at 31 March 2011 (2010 £63k).

There are no contingent assets at 31 March 2011 (nil at 31 March 2010).

There are no contingent liabilities at 31 March 2011 (nil at 31 March 2010). Any liabilities concerning environmental pollution are considered to be pre-Trading Fund events and the liability therefore falls to the MOD.

17 FINANCIAL INSTRUMENTS

DSG's treasury operations are governed under the Government Trading Funds Act 1973 (a) as supplemented by DSG's Framework Document and are conducted within a framework of policies, mandates and delegations authorised at the top level by the Board and regularly reviewed. DSG's financial instruments comprise cash deposits, debtors, creditors and loans. DSG uses forward foreign currency sales and purchase contracts as derivative instruments when required for risk management purposes only, although none have been utilised during 2010/11 (nil during 2009/10). The main purpose of these financial instruments is to finance DSG's operations and DSG has limited powers to borrow or invest surplus funds. The main risks arising from the financial instruments are foreign currency, liquidity and interest rate risks. DSG's policies for managing these risks are set to achieve compliance with the regulatory framework including the rules contained within Managing Public Money.

Interest Rate Risk

DSG's funding is determined by fixed rate Government loans. There are no floating rate liabilities and DSG has only one loan with an interest rate of 4.6% fixed for the remaining 17 years of the loan term.

Currency Risk

DSG conducts business in Sterling, US Dollars, Euros and Swedish Krone and is therefore subject to foreign exchange risk. At 31 March liabilities of $3k US Dollars and E4k Euros existed. An adverse movement in foreign currency exchange rates of 10% for these currencies would give rise to addition liabilities of £1k and £1k respectively.

DSG manages this risk by natural hedging and entering into forward foreign exchange contracts where amounts are material. DSG has one active foreign currency bank account which held $236k US Dollars at 31 March 2011 ($302k at 31 March 2010). DSG policy states that transactions are translated at the prior month average rate. Year end foreign denominated net assets are translated at a year end spot rate.

Liquidity Risk

In excess of 70% of DSG's loans outstanding at the year end are repayable in more than 5 years. Current liquidity throughout the year was strong. Cash at bank is available on demand and short term investments are conducted through the Lloyds TSB Bank plc Money Market.

Counter-party/Credit Risk

DSG's approach is to minimise counter-party risk by aiming only to enter into contracts with institutions with long term credit ratings of AA or better.

Capital Management

The financial strategy of DSG supports its aim of sustaining its manufacturing capability and achieving the return on capital objectives set by its owner. The key elements of the strategy are:

- Sufficient flexibility for the funding of necessary capital expenditure and working capital required for any expansion of the business.
- Avoidance of risk and compliance with HM Treasury policies.
- Funding of dividend payments as agreed with the owner.
- Funding of loan repayment schedules.

The Capital structure of DSG is based on management's judgement of the balancing of all the elements of its financial strategy in order to meet its day-to-day and strategic needs. DSG together with its owner considers the amount of Public Dividend Capital in proportion to Loans and retained earnings and manages the capital structure and makes adjustments to it in the light of changes in economic conditions and risk characteristics of the underlying assets. DSG will take appropriate steps to maintain and if necessary adjust the capital structure.

DSG is not subject to covenants in any of its financing agreements.

Categories of Financial Instruments

Financial assets

	At 31 March 2011 £'000	At 30 March 2010 £'000
Trade, sundry and other debtors	53,575	42,419
Cash on short term deposit, at bank and in hand	36,090	34,567
	89,665	**76,986**

Financial liabilities

	At 31 March 2011 £'000	At 30 March 2010 £'000
Trade and other payables	29,448	24,755
Ministry of Defence loans	28,289	29,954
	57,737	**54,709**

DSG does not hold any held to maturity investments or available for sale financial assets, or any financial assets or liabilities held for trading. For all assets and liabilities amortised cost is a proxy for fair value due to the short term nature of the instrument.

Embedded Derivatives

In accordance with FRS 26 – Financial instruments: Recognition and measurement, DSG has reviewed all material contracts for embedded derivatives that are required to be separately accounted for if they do not meet certain requirements set out in the standard. No instances were found that required embedded derivatives to be recognised at their fair value, separately from the non-derivative host contract. For the contracts reviewed, the economic characteristics and risks were closely related to those of the host contract.

18 RELATED PARTIES

The MOD is a related party. During the year, DSG has had material transactions with the Department and with other entities for which MOD is the parent department. None of the DSG Board members or key managerial staff have any related party interests which may conflict with their management responsibilities.

19 EVENTS AFTER THE REPORTING PERIOD

There were no significant events after the reporting period. The Accounting Officer authorised these financial statements for issue on 30 June 2011.

20 LOSSES AND SPECIAL PAYMENTS

There were no material losses or any special payments made during the year.

21 AUDITORS

The Trading Fund Act 1973 requires DSG's Annual Report and Accounts to be audited by the Comptroller and Auditor General. DSG's auditor is the National Audit Office (NAO). The cost of this audit is £95,000 (2009/10 £99,800) The Key Targets within the Annual Report and Accounts are audited by the MOD Defence Internal Audit Service.

22 THIRD PARTY ASSETS

In connection with contracts held with the Jordanian Armed Forces, DSG holds in its name a bank account, controlled by a member of the Jordanian Armed Forces, with a balance of £388k as at 31 March 2011 (£632k as at 31 March 2010).

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